



# Issues in the Market Manipulation Rulemaking



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National Petrochemical and Refiners Association



**NPRA**

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# Overview of Presentation

- I. The FTC and the Petroleum Industry
- II. Critical Issues in a Market Manipulation Rule
- III. Set an Effective Date that Allows for Full Compliance

## The FTC and the Petroleum Industry

- A. Global market forces drive petroleum prices
- B. The FTC studies this industry intensively, and vigorously scrutinizes it
- C. This rulemaking presents challenging issues

## Global Market Forces Drive Petroleum Prices

- Gasoline prices may be volatile at times, driven by changes in the global price of crude oil that account for the vast majority of price changes:
  - According to the FTC, over time changes in crude oil prices account for approximately 85% of the change in gasoline prices. Unplanned supply reductions cause occasional local price spikes. Nevertheless, any large increase in prices provokes immediate political attention.
- Although new refineries in the United States have not been built, refiners have expanded domestic capacity significantly through “debottlenecking.”
  - These refineries operate at or near their practical maximum utilization rates in times of sufficient demand
  - Although experiencing periods of “boom” and “bust,” oil industry profitability is commensurate with other industries.

## The FTC Studies This Industry Intensively, and Vigorously Scrutinizes It

- The FTC has conducted well over 100 investigations of the petroleum industry and has concluded that American consumers benefit from an industry that is nimble and responsive to market conditions. In fact, the FTC applies tough standards to this industry, leaving it relatively unconcentrated. The FTC's studies have demonstrated that:
  - The industry has provided flexible and innovative responses in cases of extreme supply and demand shocks;
  - Supplies flow toward areas of shortage where consumers are in greatest need; and
  - Price volatility exists, but domestic markets adjust efficiently in response to supply or demand fluctuations.
- Congress has nevertheless authorized the FTC to implement a Rule designed to ensure that manipulative conduct does not harm consumers.

## This Rulemaking Presents Challenging Issues

- Any Rule should:
  - Ensure effective enforcement against fraudulent conduct that distorts the market;
  - Enable the FTC to identify and remedy violations using procedures that are not unduly burdensome; and
  - Articulate with sufficient clarity the harmful conduct so that industry can fully comply while maintaining the operational flexibility to keep supplies flowing in response to consumer demand.

## Critical Issues in a Market Manipulation Rule

- A. Protect pro-competitive supply responses
- B. Both the RNPRM Rule and Alternative Rule are fraud-based and avoid second-guessing supply decisions.
- C. Avoid overly-broad regulation that will chill the flow of useful information
- D. The Alternative Rule with its great clarity and certainty is superior to the RNPRM Rule because it protects pro-competitive negotiations and commercial information exchange, and is more flexible and easier to understand. The Alternative Rule:
  - 1. Excludes omissions
  - 2. Requires “market distortion” for all actionable conduct
  - 3. Requires intent for all actionable conduct

## Protect Pro-Competitive Supply Responses

- A Rule should avoid second-guessing supply decisions. Clear guidance is needed to exclude liability for the industry's core supply functions:
  - Performance of contractual supply obligations to existing customers and
  - Market-responsive supply and inventory decisions.
- Every supply decision is a decision about the market to be served, the timing of the sale, and the buyer.
  - Because demand is highly inelastic in the short run, those decisions will inevitably influence prices.
  - Prices will increase for some markets, time periods, and buyers, and decrease for others.



## Protect Pro-Competitive Supply Responses

- Judgments about the “right” mix of sales and distribution are beyond the capacity of any individual or organization to make accurately.
  - Our economy therefore relies on markets to make such decisions and on the profit motive to guide the behavior of individual firms.
  - Second guessing those outcomes would risk serious disruptions of a well-functioning, competitive market, including jeopardizing the availability of supply.

## Both the RNPRM Rule and Alternative Rule are Fraud-Based and Avoid Second-Guessing Supply Decisions.

- In its NPRM and RNPRM, the Commission stated its intent to issue a fraud-based Rule.
- In these notices, the Commission also disavowed any intention to regulate supply decisions absent evidence of fraud.
- Eliminating the fraud basis for the Rule would subject ordinary supply decisions to potential liability. Such liability would necessitate compliance measures that would deter or potentially disrupt efficient, timely supply responses.
- The Commission should make clear in its Statement of Basis and Purpose that any Rule would affect only actions taken with an intent to defraud and thus influence market outcomes.

## Avoid Overly-Broad Regulation that Will Chill the Flow of Useful Information

- Wholesale petroleum markets currently function efficiently, effectively moving product to locations where it is needed, with prices reflecting market realities.
- Wholesale petroleum market participants are sophisticated and understand the incentives of their counterparties.
- Decisions now made in real time, with less than perfect information, will be subject to ex post scrutiny.
- An overly-broad manipulation Rule could cause particularly difficult problems with the exchange of information during emergencies, which require creative and immediate responses.
- A Rule should be clear, easy to follow, and not discourage information exchange.

## Omissions

- Applying the Rule to omissions will disrupt the flow of valuable information between market participants (and sometimes the public) that benefits consumers. The Alternative Rule recognizes these issues and excludes omissions.
- If the Commission adopts a Rule to cover omissions, it should adopt one that excludes from coverage:
  - Silence (or no comment);
  - Inadvertent conduct; and
  - Mistakes.
- Further, it should not require information corrections and updates.
- Alternatively, the Commission could make clear in its Statement of Basis and Purpose that it will not view these actions as Rule violations.

## Omissions

- To protect pro-competitive price negotiations and information exchange, any Rule should make clear in its Statement of Basis and Purpose that the Commission expects that companies will:
  - Engage in routine commercial price discovery without obligation to disclose confidential or competitively-sensitive information;
  - Use best business judgment to disclose or withhold information about confidential operational matters, strategic plans, or commercial negotiations;
  - Respond to the best of their ability to requests for information from governmental authorities; and
  - Use best practices for information disclosure during supply disruptions and designated emergency situations.
- Any Rule should avoid disclosure obligations on these points. Otherwise, industry compliance measures will necessarily restrict important information flow to avoid liability for omissions unrelated to fraudulent intent.

## “Effect on the Market”

- Any Rule should require an “effect on the market” for all actionable conduct.
  - Any manipulation rule should focus on the conduct that Congress sought to address: acts and practices that manipulate a market.
  - Although a price effects standard is preferable, the Alternative Rule, which applies a market distortion requirement to all covered conduct, is superior to the RNPRM Rule.
  - Any market distortion requirement should eliminate the “tends to distort” language in favor of actual distortion or conduct likely to distort under the circumstances.
  - If the Commission favors the two-pronged approach of the RNPRM, a market effects or market distortion requirement should apply to affirmative acts as well as to omissions.
  - A final rule should not federalize garden variety fraud, which is covered already by state law.

## Specific Intent

- Any rule should require specific intent for any actionable conduct.
  - A rule should have a single, clear standard for intent – specific intent to deceive or defraud in order to manipulate a covered market.
  - Although deficient because it does not require specific intent, the Alternative Rule's intent standard is superior to the intent standards in the RNPRM Rule.
  - Any final rule should not apply to individual, bilateral market transactions, unless the speaker intended or expected to affect market conditions.

## Set an Effective Date that Allows for Full Compliance

- The Commission should provide a reasonable time period to enable the industry to design and implement comprehensive compliance programs.